BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
VISA U.S.A., INC.)

For Appellant: Robert C. Alexander
Attorney at Law

For Respondent: Claudia K. Land
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Visa U.S.A., Inc., against proposed assessments of additional franchise tax in the amounts of $8,384.89, $14,870.34 and $16,177.00 for the income years ended September 30, 1973, September 30, 1974, and September 30, 1976, respectively.

The first issue is whether expenditures for the purpose of influencing legislation are deductible as business expenses. If we find that such expenditures are nondeductible, we must then determine what portion of the expenses in issue were incurred for the purpose of influencing legislation.

Visa U.S.A., Inc., a Delaware corporation, administers the "VISA" bank card system. It acts as a clearing house between member banks, authorizes credit purchases, promotes the use of the VISA card, and develops new uses for the card. In 1972, appellant established an office in Washington, D.C. The primary employee in this office is a registered lobbyist. The primary functions of the Washington office are: to keep abreast of and analyze the impact of legislative and regulatory developments; to present appellant's opinions to legislators and regulatory agencies; to clarify existing regulations; to communicate with competitors regarding federal regulations and statutes; to publish and distribute a newsletter to members; to furnish information concerning VISA and the industry to Congress and regulatory agencies; and to resolve consumer complaints. For the taxable years ended September 30, 1973, 1974 and 1976, appellant deducted all expenses associated with the Washington, D.C. office as business expenses. Upon audit, respondent determined that the Washington office was maintained for the purpose of influencing legislation and concluded that, for this reason, the expenses associated with that office were not deductible. Respondent issued a proposed assessment reflecting this determination for each of the years at issue. Appellant protested the assessments, and respondent modified them to allow a deduction for the expenses attributable to the resolution of consumer complaints. The assessments, as modified, were affirmed and this appeal followed.

The Revenue and Taxation Code allows a corporation to deduct "all the ordinary and necessary expenses paid or incurred during the income year." (Rev. & Tax. Code, § 24343.) However, the code specifies that certain expenses are not deductible even when they meet the requirements of being ordinary and necessary. These expenses include bribes and kickbacks, fines and penalties assessed because of violations of law, and portions of antitrust judgments. (Rev. & Tax. Code, § 24343, subds. (b), (e) & (f).) Internal Revenue Code section 162 is substantially similar to Revenue and Taxation Code section 24343 except that section 162 contains a subdivision, enacted in 1962, which specifies that

certain lobbying expenses, such as the expenses in issue in this appeal, are deductible. (Int. Rev. Code of 1954, § 162, subd. (e).) The California statute is silent as to the deductibility of lobbying expenses.

The threshhold question is whether appellant's expenses associated with its Washington, D.C. office qualify as ordinary and necessary. This is a factual question which must be considered in light of the taxpayer's business. (Commissioner v. Heininger, 320 U.S. 467 [88 L.Ed. 171] (1943).) An expense is necessary if it is appropriate and helpful in carrying on the taxpayer's business; it need not be indispensable. (Commissioner v. Heininger, supra.) The requirement that an expense be ordinary serves to separate expenses from capital expenditures. (Commissioner v. Tellier, 383 U.S. 687 [16 L.Ed.2d 185] (1966).) This requirement is met if the expense is a normal expense which, in the taxpayer's type of business or situation, would be expected to be incurred. (Lilly v. Commissioner, 343 U.S. 90 [96 L.Ed. 769] (1952).)

We conclude that the expenses incurred by appellant in connection with its Washington office are ordinary and necessary business expenses. The business of credit card systems is subject to no less than six major federal acts and subject to regulation by at least five federal agencies. In so highly regulated an industry, it is certainly appropriate and helpful, indeed indispensable, to keep aware of the latest legislative and administrative developments. To attempt to make the industry's views and opinions known to both Congress and administrative agencies is also clearly helpful to their business and, for this type of business, is a normal expense. Apparently, respondent agrees with this conclusion. It denied the deduction, not on a factual finding that the expenses were not ordinary and necessary, but rather on the ground that California law prohibits the deduction of all lobbying expenses.

Respondent relies primarily upon two Supreme Court cases in which lobbying expenses were held to be nondeductible business expenses. (Commarano v. United States, 358 U.S. 498 [3 L.Ed.2d 462] (1959); Textile Mills Securities Corp. v. Commissioner, 314 U.S. 326 [86 L.Ed. 249] (1941).) Respondent asserts that these cases are relevant to the instant appeal since they were decided at a time when the California and federal statutes were identical and since the reasoning of these cases has been adopted by this board. (Appeal of First Federal

Savings and Loan Association of Altadena, Cal. St. Bd. of Equal., April 20, 1960.) However, at the time the above cited cases were decided, there was a Treasury regulation and a substantially similar California regulation in effect which specifically stated that lobbying expenses could not be deducted by a corporation as business expenses. (Former Treas. Reg. 111, § 29.23 (q)-(l); Cal. Admin. Code, tit. 18, reg. 24121(k)-24121 (k)(l) (Repealer filed March 20, 1970, Register 70, No. 12).) These cases merely held that the regulation was valid, and went on to interpret and apply the regulation. None of these cases contain any indication that lobbying expenses would be nondeductible had the regulation not applied. The California regulation which stated that lobbying expenses were not deductible was repealed in 1970; during the years at issue no California regulation prohibited the deduction of lobbying expenses as a corporate business expense. Where a regulation which has been the basis for a particular construction of a statute is amended or repealed, the manner in which the statute is construed is also changed. (Commissioner v. Sunnen, 333 U.S. 591 [92 L.Ed. 898] (1948); Commissioner v. Security-First National Bank, 148 F.2d 937 (9th Cir. 1945).) Therefore, the above cited cases do not control the decision in this appeal.

Respondent points out that during the years at issue, the regulations prohibited a corporation from deducting as a charitable contribution under section 24357 contributions to any organization that performs certain political or lobbying activities. (Cal. Admin. Code, tit. 18, reg. 24357-24359(a).) Respondent attempts to extend the application of regulation 24357-24359(a) to disallow a deduction under section 24343. However, the regulation does, not prohibit the deduction of lobbying expenses as business expenses and a regulation which prohibits deduction of a certain expense under one particular code section does not act to bar the deduction of that 'expense under a different code section. (Coughlin v. Commissioner, 203 F.2d 307 (2d Cir. 1953).)

Respondent asserts that former regulation 24121(k), which prohibited a deduction for lobbying expenses, was repealed for technical reasons and that the repeal did not indicate a change in respondent's position concerning the deduction of lobbying expenses. Assuming this to be true, it is not pertinent to this appeal. An administrative agency's unpublished, internal position is not the equivalent of a published regulation and is not granted the deference accorded a regulation.

(Culligan Water Conditioning v. State Board of Equalization, 17 Cal.3d 86 [130 Cal.Rptr. 321; 550 P.2d 593] (1976).)

Respondent's second argument is that lobbying expenses violate public policy and, therefore, are not deductible. Prior to 1969,[1/] federal courts narrowly construed the phrase "ordinary and necessary business expenses" when allowing an expense to be deducted would frustrate "sharply defined national or state policies." (Commarano v. United States, supra.) The recognition of public policy as a ground for denying a deduction was not limited to cases where there was a specific regulation prohibiting the deduction. (See, e.g., Tank Truck Rentals v. Commissioner, 356 U.S. 30 [2 L.Ed.2d 562] (1958).) However, in situations where the deduction of an expense was not prohibited by either statute or regulation, it was only in extremely limited circumstances that the Court approved of exceptions to the general principle that all ordinary and necessary business expenses are deductible. (Commissioner v. Tellier, supra.) The cases decided by the Supreme Court illustrate the limited application of the frustration of public policy doctrine. For example, the Court refused to hold the following types of expenses nondeductible on public policy grounds: referral fees paid to doctors by a taxpayer engaged in the optical business (Lilly v. Commissioner, 353 U.S. 90 [96 L.Ed. 769] (1952)); legal expenses incurred by a mail order dentist in connection with the unsuccessful defense against criminal mail fraud charges (Commissioner v. Heininger, supra); and expenses incurred by an illegal business (Commissioner v. Sullivan, 356 U.S. 27 [2 L.Ed.2d 559] (1958)).

1/ In 1969, Congress amended Internal Revenue Code section 162 by adding several subsections which specifically prohibit the deduction of certain expenses because the allowance of a deduction for these expenses would frustrate public policy. (Int. Rev. Code of 1954, § 162 subds. (c), (f) and (g).) In doing so, Congress indicated that it was pre-empting this area, and that no longer should either the courts or the Internal Revenue Service disallow a deduction on public policy grounds. Current Treasury Regulations reflect this intent. (Treas. Reg. § 1.162-1(a).)

Before a deduction can be denied on frustration Of public policy grounds, "[t]he policies frustrated must be national or state policies evidenced by some governmental declaration of them." (Lilly v. Commissioner, supra, at p. 97.) The cases in which a deduction was denied on public policy grounds fall primarily into two categories; those in which the expenditures themselves were illegal, and those in which the expenditures were in payment of fines or penalties. (Tank Truck Rentals v. Commissioner, supra; United States v. Winters, 261 F.2d 675 (10th Cir. 1958).) These cases are clearly distinguishable from the facts of this appeal. Lobbying is not only a legal activity for a corporation, it is constitutionally protected. (First National Bank of Boston v. Bellotti, 435 U.S. 765 [55 L.Ed.2d 707] (1978).)

Respondent argues that the California Legislature has declared a state policy against the allowance of deductions for lobbying expenses in that it has denied deductions under other code sections for contributions to political organizations and expenses associated with political activity. (See, e.g., Rev. & Tax. Code, §§ 17293, 24434, 17214, 24359.) This is not the type of governmental declaration of public policy which has provided a basis for disallowance of deductions on public policy grounds. We cannot conclude that merely because lobbying expenses are not deductible under some sections, the Legislature intended that they not be deductible under section 24343. Section 24343 specifically prohibits the deduction of certain expenses; lobbying expenses are not among those expenses. (Rev. & Tax. Code, § 24343, subd. (b).) Although there are policy considerations which may lead to the conclusion that corporate lobbying expenses should not be deductible, such a matter is for the Legislature, not this board, since we merely interpret and apply the laws as written.

The expenses incurred by appellant in connection with its Washington, D.C., office are ordinary and necessary expenses incurred in connection with legal activities. Since neither the statute nor any regulation prohibits the deduction of lobbying expenses, and since there is no legal precedent for disallowing the deduction of such expenses on public policy grounds, a deduction for these expenses must bc allowed.

For the foregoing reasons, the action of respondent must be reversed.

Since we have concluded that expenditures for the purpose of influencing legislation are deductible, it is not necessary to determine what portion of the expenses in question were incurred for that purpose.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Visa U.S.A., Inc., against proposed assessments of additional franchise tax in the amounts of $8,384.89, $14,870.34 and $16,177.00 for the income years ended September 30, 1973, September 30, 1974, and September 30, 1976, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 29th day of June , 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett , Chairman

Ernest J. Dronenburg, Jr. , Member

Richard Nevins , Member

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